



Investor Group on
Climate Change

A CHANGING CLIMATE

What investors expect
of company directors
on climate risk



About the Investor Group on Climate Change

The Investor Group on Climate Change (IGCC) is a collaboration of Australian and New Zealand institutional investors focused on the impact of climate change on investments. IGCC represents investors with total funds under management of over \$2 trillion in Australia and New Zealand and \$20 trillion around the world. IGCC members cover over 7.5 million people in Australia and New Zealand.

www.igcc.org.au

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Disclaimer

This report has been developed using publicly listed corporate reporting, however this analysis is general in nature and may not provide a full and fair representation of company disclosure on climate change. The information in this report should not be interpreted as investment or legal advice, and is provided for general information purposes only.

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EXECUTIVE SUMMARY

Background

There is increasing pressure on companies, particularly those in carbon-intensive and fossil fuel sectors, to integrate climate change considerations into their strategy, capital expenditure and approach. Fundamentally, management of climate risk is the board's responsibility.

However, many companies are not acting decisively on climate. There are significant weaknesses in many companies climate approaches, including the lack of credible strategy and targets that align with the goals of the Paris Agreement. Many companies have misjudged the pace of technology and policy change which has led to poor financial outcomes for shareholders. Company disclosure is still mixed, and capital allocation to climate solutions is significantly outweighed by investments in carbon intensive assets. Boards that fail to recognise the significant material risk climate change presents and the role they play in developing and driving the company transition to a low carbon business model are leaving the firm exposed to strategic and market risk.

The need for companies and boards to address climate change has been known for some time. However, the relatively recent disclosure of climate change strategies, the incomplete assessment of climate risks and the inconsistent messages from companies and their industry associations on climate change raises questions about whether many of the current and past directors on Climate Action 100+ (CA100+) companies have the skills and experience to take Australian companies forward as they address the complex and multifaceted climate change-related issues. This puts pressure on boards to clearly demonstrate that the directors have the necessary skills, outlook and expertise required.

The challenge for investors is that based on publicly available information it is difficult to discern the current level of climate change competency and level of focus on company boards. In many cases, investors rely not only on company specific climate change disclosure but also on proxy measures, for instance, results presentations, strategy presentations or consistency of investment decisions with climate change action, to understand a company's focus and strategy on climate change.

Report objective and approach

The objective of this report is to clearly articulate Australian investors' expectations by detailing the experience, action and responsibilities required to constitute a climate competent board.

This report assesses the climate change governance approaches for the fifteen companies¹ engaged by the CA100+ initiative in Australasia, looking at two main issues:

1. The overall climate competency of the board, including:
 - A. Board structures and committees
 - B. The board skills matrix
 - C. Director competency
 - D. Board education and stakeholder engagement

2. The climate outcomes delivered by the board, including:
 - A. Climate change integrated into strategy
 - B. Climate change leadership and the CEO
 - C. Climate change risk management oversight
 - D. Climate change disclosure and communication

The aspects detailed above are proxy measures selected to provide insights into a board's focus and approach to climate change and to identify gaps and weaknesses. While the observations outlined are from a review of the CA100+ companies, the expectations of investors apply not only to the CA100+ companies but all listed companies.

The expectations of investors are also linked to the [World Economic Forum Climate Change Governance Principles](#) and the specific guiding questions.

Climate competency of boards: analysis of current practice

In reviewing the climate competency of the fifteen Australasian CA100+ focus companies using the themes indicated above, this report found a number of trends of interest to investors.

Board structure and committees

Boards often allocate responsibility for climate change to the sustainability committee however, the remit of this committee does not typically cover the full suite of risks and strategic challenges posed by climate change. There is also little disclosure of the exact activities undertaken by board committees, making it hard for investors to know how they are managing climate change risk.

Board skills matrix

Climate change is emerging as a skill identified in the board skills matrix, but it is very unclear what is indicated by 'climate change skills' as companies do not typically provide criteria. Investors would also expect many companies highly exposed to the transition and physical risks of climate change to seek directors with disruption and transition expertise, but there is little evidence this is happening – rather, there is a strong trend of directors with experience from the incumbent industry which may be anchoring the business in existing strategies.

Director competency and backgrounds

Very few current board directors of the CA100+ companies reviewed can clearly demonstrate, through the description of their skills and experience presented in annual reports or other publicly available sources, that they would meet the requirements of a "climate competent" director. While this is understandable, given the challenges in recruiting directors with such experience and may be addressed in other ways, it is notable given the materiality of the climate risks faced by the assessed companies. There is little evidence that the chair or members of a sustainability committee, typically assigned the remit to have oversight of climate risk, have particular skills or experience relevant to climate change. Additionally, several current and past directors of CA100+ companies were found to have a history of stifling action on climate change, which is a concern to investors as they may be continuing to play an obstructive role.

Board education and stakeholder engagement

There is little disclosure of company's efforts to keep board directors informed on the latest science, policy, technology, data and reporting requirements relevant to the company's response to climate change, which appears to be a gap given climate change is a highly material risk for all companies assessed.

Outcomes of a climate competent board: analysis of current practice

In reviewing the climate outcomes of the fifteen Australasian CA100+ focus companies using the themes indicated above, this report found a number of trends of interest to investors.

Climate change strategy

Only one board of the fifteen companies analysed identified climate change strategy as a responsibility of the board. Climate change strategies were generally not integrated into the overarching company strategy. Often, there were misalignments within the strategy evidenced by capital allocation to climate solutions and allocation to carbon-intensive projects. Many companies cite offsets and negative emissions technologies as key climate strategies rather than abatement or transition, which may indicate an unwillingness to adapt the business model to emerging and escalating risks. Statements from relevant industry groups also suggest that companies are still not focused on pursuing a transition to new business models.

Climate change and risk oversight

Climate change is increasingly being identified by companies as a significant material risk. However, there are gaps in the way the risk appears to be understood, and very few companies include technology risk and opportunity, market risk and opportunity, litigation and physical risks in their approach. A few companies have moved oversight of climate risk to the Risk or Risk and Audit Committee in recent years.

The company CEO

Strong CEO leadership on climate change, while a positive, at times halted sharply when the CEO departed. This trend confirms the key role of the board and in particular the Chair in setting the strategy. CEOs were rarely incentivised to achieve climate targets, and in many cases are incentivised to achieve goals which appear misaligned with emissions reductions.

Disclosure and communication

Companies are increasingly referencing climate change, but often this is siloed to the climate change or sustainability report and not reflected in other communications to investors such as the annual and financial reports and investor presentations. Disclosures in sustainability reports often miss key risks such as technology, market and value chain risks and physical risks.

Investor expectations for climate competent boards

Australian companies need directors that recognise global policy signals and the need for changing business models in response to climate change risks and opportunities. For this reason, directors that anchor companies to existing business models, and stifle policy or corporate action on climate change are unlikely to meet investor expectations. It is likely that directors will face additional risks including litigation risk as well as the possibility for shareholder escalation and/or regulatory action if they do not act with the best long-term interests of the company in managing climate risk.

The expectations outlined in this report are aimed at supporting constructive and positive investor engagement with companies on climate risk and governance. In particular, the investor expectations set out in this report are designed to be used as guidance for both companies and investors to help boost company disclosure and practice on climate governance.

The time for action on climate change is rapidly decreasing to meet the Paris Agreement goals and limit global warming to relatively safe levels. Company boards, with support from investors, can, and must, position companies to not only manage the multifaceted aspects of climate change-related risk but position the company for long-term value creation for shareholders and society.

Summary of investor expectations on board competency on climate change

The following table covers the set of expectations that have been developed to support investor engagement with companies on climate risk. The particular themes are covered in more detail in the report.

Board structure and committees	<ol style="list-style-type: none"> 1. Board committee(s) have specific responsibility for the strategic², operational, technology, non-operational, value chain and financial aspects of climate change. 2. The risks from climate change are multi-faceted and boards need to demonstrate how climate change risks are captured through the Terms of Reference or Charters of specific committees. 3. Specific oversight of Taskforce for Climate-related Financial Disclosures (TCFD) reporting should be identified. 4. Board committees should disclose the significant climate change-related issues that they have considered and the outcomes of these considerations.
Board skills matrix	<ol style="list-style-type: none"> 1. Report on how the skills matrix is developed and the process of assessing director skills on climate-related issues. 2. Independent assessment, or audit, of company director skills. 3. A brief description of the criteria the board uses to assess each skill or background in the skills matrix. 4. Differentiation between directors with significant expertise or experience of a particular skill, versus knowledge or awareness in a particular area. This applies not only to climate change-related skills but all skills identified in the board skills matrix. 5. Disclosure of a board succession plan outlining how necessary climate change-related skills will be brought onto the board. <p>Regarding specific skills required on the board, investors are looking for:</p> <ol style="list-style-type: none"> 1. Technology and innovation skills, specifically recent experience and expertise with the development, selection and implementation of business transforming technology and innovation and responding to climate-related and digital disruption. 2. Oil and gas company board skill sets should include: "Company Transformation", i.e., a demonstrated ability to constructively challenge conventional business models that are facing significant disruption and redirect a company's core competencies into a viable alternative strategy. 3. Utility company board skill set should include: "Dealing with strategic disruption", i.e., demonstrated experience in successfully guiding a company through a disruption that is fundamentally challenging the company's business model. 4. "Climate competent" directors, i.e., has the expertise and experience of climate-related business threats and opportunities including climate science, low carbon transition across the value chain and public policy.

Director competency and backgrounds	<ol style="list-style-type: none"> 1. Disclosure of relevant experience and expertise: Details of director backgrounds need to demonstrate the expertise and experience they bring to the board, such that it is clear from director information the basis of the assessment of the board's skill matrix. 2. Constructive contribution to climate change policy development: Directors are expected to provide a positive and consistent contribution to climate change policy discussion. Investors are unlikely to support directors with a history of arguing for policy delay or inaction on climate change. 3. Accountability for climate change governance: Directors, especially those of board committees, will need to take responsibility and accept that investors will keep them accountable for the climate change competency of the board.
Board education and stakeholder engagement	<ol style="list-style-type: none"> 1. The board induction process includes: <ol style="list-style-type: none"> A. Relevant climate change issues facing the company B. The company's climate change strategy C. The board's climate change risk management oversight. 2. The board can demonstrate that in the past year they have continued to be educated about the relevant climate-related risks and opportunities for their business. The board demonstrates that over the year it has engaged external expertise and stakeholders, including shareholders, on climate change issues.
Climate change and strategy	<ol style="list-style-type: none"> 1. The company has a coherent climate change strategy which is integrated into the company's strategy including capital expenditure. 2. The company clearly articulates the underlying climate change-related assumptions that lie behind the company strategy and capital expenditure decisions, particularly with respect to: <ol style="list-style-type: none"> A. rate of technology change assumptions B. assumed policy settings C. emission reduction targets for scope 1, 2 and 3. 3. The company undertakes robust climate change scenario analysis and disclose capital investments, or assumptions, consistent with the Paris Agreement objective of aiming to limit global warming to 1.5°C. 4. The company integrates the management of the social impacts that may result from changes in company business models. 5. The strategy takes advantage of the opportunities that arise from action on climate change. 6. Carbon offsets are used as a last resort in the company's medium- to long-term strategy to manage climate change. 7. The climate change transition strategy for oil and gas companies is the company strategy.

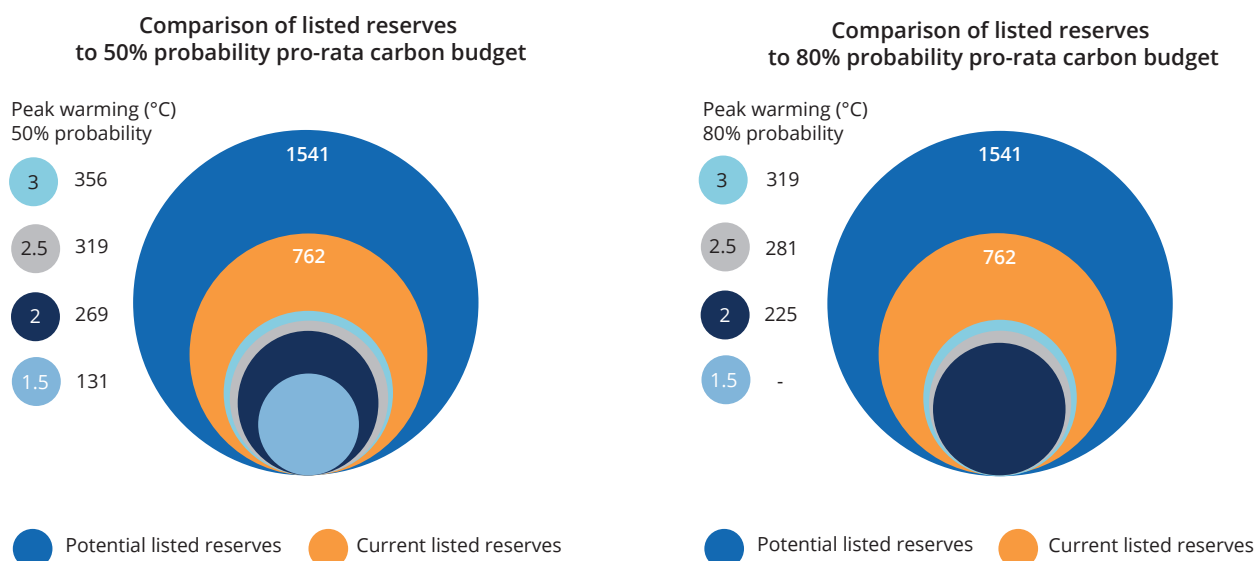
Climate change and risk oversight	<p>Investors do not want a separate risk management process for managing climate change-related risks but do want disclosure by companies to make clear:</p> <ol style="list-style-type: none"> 1. The process of identifying and considering all the financial, operational and strategic aspects of climate change risk and that these have been considered over the short-, medium- and long-term, recognising that some climate change risks may only manifest themselves in the medium- to long-term, e.g., physical risks. 2. The process of how climate change is integrated into the company's overall risk management process and how the existing process has been adapted to incorporate the specific characteristics of climate change risk which mean that existing risk management frameworks are not adequate. 3. The risk appetite for and the processes to manage the climate change risks.
Climate change leadership and the CEO	<ol style="list-style-type: none"> 1. The CEO and Chair to show company leadership by ensuring action on climate change and minimising misalignment or inconsistencies in the approach to climate change across the company. 2. Remuneration structures of the CEO and key performance indicators (KPIs) should incentivise achievement of the climate strategy and emissions reduction targets. 3. Remuneration structures should not include incentives inconsistent or conflicting with improving a company's climate change resilience and reducing emissions.
Climate change disclosure and communication	<ol style="list-style-type: none"> 1. Consistent, comprehensive and complete climate change disclosures and communication across all channels used to communicate to investors. 2. Prepare TCFD reporting that: <ol style="list-style-type: none"> A. Provides a thorough overview of the company's governance, strategy, processes for managing climate-related risks, and performance with respect to managing climate-related risks. B. Considers all climate change risks and opportunities. C. Presents information in sufficient detail and sets targets, including emission reduction targets that can be used to assess performance of the company. D. Considers and addresses the different time frames and types of impacts. E. Communicates financial information which is sufficiently granular and serves the needs of a range of financial sector users. F. Explains any changes in approach. G. Includes robust scenario analysis, including a 1.5°C scenario and clearly articulates assumptions made about technology, policy and market conditions. H. Identifies the current and future capital expenditure or investments that are inconsistent with achieving a 1.5°C scenario. I. Presented to investors through the mainstream channels used to communicate to investors. 3. Prepare an annual "Say on Climate" vote for the company's AGM. 4. Climate reporting should be incorporated into the company's financial statements using the financial metrics typically used by the company, e.g., Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA).

INTRODUCTION

Climate change and the board's role

The need to significantly reduce global greenhouse gas emissions to limit the negative global environmental, social and financial impacts associated with climate change has been acknowledged by governments around the world for nearly 30 years³. The lack of sufficient action by both governments and industry to reduce emissions has led to a sense of greater urgency to act, not only to reduce emissions but also to manage the physical impacts of climate change that are locked in, due to historic inaction. The past inaction plus continued delay in setting sufficiently robust emissions reduction targets may lead to global average temperature rise of more than 2°C.

The 2015 Paris Agreement⁴ set a goal to limit global warming to well below 2°C, preferably to 1.5°C, compared to pre-industrial levels. The scale of the task to limit global warming has also been known for some time. For example, in 2013, Carbon Tracker and Grantham Research Institute highlighted that between 60-80% of coal, oil and gas reserves of publicly listed companies are 'unburnable' if the world is to have a chance of staying below global warming of 2°C⁵. The same report also highlighted the risk of "stranded assets".



While the Carbon Tracker report focussed on the fossil fuel sector, there were clear implications for other emission intensive industries, such as steel, cement and other industries heavily reliant on fossil fuels, including but not limited to, some infrastructure and airline sectors. The World Economic Forum's (WEF) annual assessment of risks has included climate change and risks which will be exacerbated by climate change, in its top five risks, by impact, since 2011. In its 2021 global risk report⁶, 'climate change failure' was the second highest risk by both likelihood and impact, with extreme weather as the highest likelihood.

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1st	Asset price collapse	Asset price collapse	Fiscal crises	Major systemic financial failure	Major systemic financial failure	Fiscal crises	Water crises	Failure of climate-change mitigation and adaptation	Weapons of mass destruction	Weapons of mass destruction	Weapons of mass destruction
2nd	Retrenchment from globalisation (developed)	Retrenchment from globalisation (developed)	Climate change	Water supply crises	Water supply crises	Climate change	Rapid and massive spread of infectious diseases	Weapons of mass destruction	Extreme weather events	Extreme weather events	Failure of climate-change mitigation and adaptation
3rd	Oil and gas price spike	Oil price spikes	Geopolitical conflicts	Food shortage crises	Chronic fiscal imbalances	Water crises	Weapons of mass destruction	Water crises	Water crises	Natural disasters	Extreme weather events
4th	Chronic disease	Chronic disease	Asset price spikes	Chronic fiscal imbalances	Diffusion of weapons of mass destruction	Unemployment and underemployment	Interstate conflict with regional consequences	Large-scale involuntary migration	Major natural disasters	Failure of climate-change mitigation and adaptation	Water crises
5th	Fiscal crises	Fiscal crises	Extreme energy price volatility	Extreme volatility in energy and agriculture prices	Failure of climate-change mitigation and adaptation	Critical information infrastructure breakdown	Failure of climate-change mitigation and adaptation	Severe energy price shock	Failure of climate-change mitigation and adaptation	Water crises	Natural disasters

■ Economic
 ■ Environmental
 ■ Geopolitical
 ■ Societal
 ■ Technological

Source: <https://www.weforum.org/reports/the-global-risks-report-2021>

ABOUT CLIMATE ACTION 100+

Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.



Climate Action 100+ engagement focuses on 167 companies that are critical to the net zero emissions transition. Investors are responsible for driving engagement and developing and implementing company specific engagement strategies. They are supported in the process by five investor networks who co-founded the initiative and technical experts.

There are now 615 investors participating in Climate Action 100+ including 15 Australian signatories.

Climate Action 100+ is coordinated by five investor networks: the Asia Investor Group on Climate Change (AIGCC), Ceres, Investor Group on Climate Change Australia and New Zealand (IGCC), Institutional Investors Group on Climate Change (IIGCC), and Principles for Responsible Investment (PRI).

The fifteen focus companies engaged in Australia and listed on the Australian Stock Exchange (ASX) are: Adbri, AGL Energy Ltd, BHP Ltd, Bluescope Steel Ltd, Boral Ltd, Incitec Pivot, Oil Search, Orica, Origin Energy, Qantas Airways Limited, Rio Tinto, Santos Limited, South32, Woodside Energy and Woolworths Group Ltd., Woolworths Group Ltd

These companies were used as the basis for the observations and recommendations made by this report, but the investor expectations are designed to be broadly applicable.

Director's Duty of Care

In 2016, Noel Hutley SC and Sebastian Hartford Davis found that under Australian law company directors may be liable for breaching their legal duty of due care and diligence under the Corporations Act, if they do not properly manage and disclose climate risk⁹.

The opinion stated:

"...it is 'conceivable that directors who fail to consider climate change risks now could be found *liable for breaching their duty of care and diligence in the future*.'"

Noel Hutley QC and Sebastian Hartford-Davis

In April 2021, the opinion was updated¹⁰, noting further developments that emphasised the foreseeability and materiality of climate risks and reinforced their opinion on the duty of care required of directors. The opinion also highlighted the litigation risks relating to greenwashing in the particular context of "net zero" commitments.

Companies play a critical role in delivering emission reductions and managing climate change impacts. Managing climate change risk is inextricably linked with company strategy, risk management and capital allocation. These areas are core to the role of boards.

Climate change risks are not only environmental; they are complex and multi-faceted, affecting every part of society and our economy. To manage the risks appropriately, company boards need strategic oversight and require a dedicated awareness of the issues.

Companies facing increased litigation risk

In May 2021, the Dutch District Court found that Shell's failure to reduce emissions on a trajectory consistent with the Paris Agreement was a breach of its duty of care to, and human rights of, Dutch citizens, and ordered it to increase its emissions reduction policy to 45% by 2030 (against a 2019 baseline). The Shell group is responsible for its own CO₂ emissions and those of its suppliers, the verdict said.

In August 2021, Australian oil and gas company Santos has been sued by an NGO over its climate approach. The lawsuit alleges the company has made misleading and deceptive claims about its environmental credentials, including that the company has a clear plan to achieve net zero emissions by 2040 and that natural gas is a 'clean fuel'.

Investor's concern with the climate change competency of boards

As universal owners⁷, institutional investors have a focus on long-term investment returns. As part of this, investors need to manage and, where possible, minimise systemic risks, such as climate change⁸.

However, investors also rely on the companies they invest in to manage climate change risk. Shareholders elect directors and rely on boards to set strategy and oversee risk management. In recent years, with the release of the TCFD guidelines (2017) and the commencement of the CA100+ initiative (2017), there has been a significant increase in the consideration, management and disclosure of climate change risks by many CA100+ focus companies. However, many companies still do not appear to be fully integrating climate change risks into their long-term strategic thinking. It should be noted that these concerns are neither new nor limited to Australian investors¹¹. Most recently we have seen investors replace Directors on Exxon's Board because of concern over how the Board was managing, amongst other things, climate change risk¹². The characteristics of climate-related risks, according to the TCFD, are set out on the following page.

Characteristics of climate-related risks¹³

Different effects based on geography and activities	The effects of climate change and climate-related risks occur on local, regional, and global scales with different implications for different businesses, products and services, markets, operations, and value chains, among others.
Longer time horizons and long-lived effects	Some climate-related risks exist and play out over time horizons that stretch beyond traditional business planning and investment cycles. These risks and related impacts may occur as a result of decades-long changes in driving forces (e.g., greenhouse gas concentrations in the atmosphere) leading to climate-related physical or transition risk changes over the short-, medium-, and long-term.
Novel and uncertain nature	Many of the effects of climate change have no precedent, limiting the ability to apply statistical and trend analysis based on historical data. Climate change is a dynamic and uncertain phenomenon and possible mitigation responses are also complex, with many unknowns such as the development and deployment of critical technologies and adaptation strategies as well as changing market and consumer behaviours.
Changing magnitude and nonlinear dynamics	Climate-related risks may manifest at different scales over time, with increasing severity and scope of impacts. Climate systems may exhibit thresholds and tipping points that result in large, long-term, abrupt, and possibly irreversible changes. Understanding the sensitivities of tipping points in the physical climate system, as well as in ecosystems and society, is essential for understanding climate-related risks.
Complex relationships and systemic effects	Risks associated with climate change are interconnected across socioeconomic and financial systems. Such interconnected risks are often characterised by knock-on effects and systemic effects, requiring a multidimensional perspective to assess the short-, medium-, and long-term implications for a company.

Companies are not acting decisively on climate risk

There are a number of signals that suggest to investors that climate risk is not yet being managed appropriately by companies:

1. Companies and their industry associations have lobbied against many policy proposals¹⁴ that may have led to stronger climate change policy in Australia.
2. Many companies make investment decisions in assets on the basis of the long-term earnings profile of the sector. However, as seen by the continual revision down of future renewable energy costs and future fossil fuel demand, many companies have underestimated the pace of innovation and technological change.
3. Capital expenditure is still very heavily weighted towards 'business as usual' activities even while companies promise modest allocations of capital for research and development, partnerships and technologies to reduce emissions. There is a trend of Australian companies reversing major investments or strategies (e.g., through sale or demerger) and/or suffering major write-downs. In many of these cases, discussions with boards and management at the time of the investment indicated a short-term focus and a lack of understanding of the risks associated with climate change.
4. Climate change disclosure, while improving, still has a range of gaps and weakness that suggests that companies do not fully understand, or are managing, climate change risks.
5. There is often substantial misalignment between executive remuneration incentives and the firm's climate strategy.

These themes are elaborated on in the 'Outcomes of a climate competent board' section of this report.

AGL ENERGY

In 2021 AGL Energy announced its intention to demerge its electric utility business and form two entities to be named AGL Australia and Accel Energy. AGL Energy Ltd is Australia's largest emitter, largely due to its portfolio of coal-fired power stations. In announcing its plans to demerge, AGL Energy Ltd Chair Peter Botton said:

"There is no doubt that the winds of change in the electricity market have been substantially faster than many people had anticipated; certainly, from my perspective, those winds have been extremely fast. I certainly didn't see quite the level of change and the acceleration of that change here in my thinking 12 months ago and I believe that would be representative of the AGL Board¹⁵."

There are many examples in the Australian market of similar major corporate actions being made abruptly to address the concerns of stakeholders on climate change, but arguably it is the board's role to understand, foresee and keep abreast of the pace of change as it relates to their organisation and its operating assets.

THE CLIMATE COMPETENT BOARD

This section focuses on the climate competent board and director.

Effective climate change governance

In January 2019, the World Economic Forum, in collaboration with PWC, released a report ["How to Set Up Effective Climate Governance on Corporate Boards - Guiding principles and questions"](#). The report outlined eight principles for effective climate change governance.

These Principles are:

World Economic Forum Climate Governance Principles

➤ Principle 1 – Climate accountability on boards

The board is ultimately accountable to shareholders for the long-term stewardship of the company. Accordingly, the board should be accountable for the company's long-term resilience with respect to potential shifts in the business landscape that may result from climate change. Failure to do so may constitute a breach of directors' duties.

➤ Principle 2 – Command of the subject

The board should ensure that its composition is sufficiently diverse in knowledge, skills, experience and background to effectively debate and take decisions informed by an awareness and understanding of climate-related threats and opportunities.

➤ Principle 3 – Board structure

As the stewards for long-term performance and resilience, the board should determine the most effective way to integrate climate considerations into its structure and committees.

➤ Principle 4 – Material risk and opportunity assessment

The board should ensure that management assesses the short-, medium- and long-term materiality of climate-related risks and opportunities for the company on an ongoing basis. The board should further ensure that the organization's actions and responses to climate are proportionate to the materiality of climate to the company.

➤ Principle 5 – Strategic integration

The board should ensure that climate systemically informs strategic investment planning and decision-making processes and is embedded into the management of risk and opportunities across the organization.

➤ Principle 6 – Incentivization

The board should ensure that executive incentives are aligned to promote the long-term prosperity of the company. The board may want to consider including climate-related targets and indicators in their executive incentive schemes, where appropriate. In markets where it is commonplace to extend variable incentives to non-executive directors, a similar approach can be considered.

➤ Principle 7 – Reporting and disclosure

The board should ensure that material climate-related risks, opportunities and strategic decisions are consistently and transparently disclosed to all stakeholders – particularly to investors and, where required, regulators. Such disclosures should be made in financial filings, such as annual reports and accounts, and be subject to the same disclosure governance as financial reporting.

➤ Principle 8 – Exchange

The Board should maintain regular exchanges and dialogues with peers, policymakers, investors and other stakeholders to encourage the sharing of methodologies and to stay informed about the latest climate-relevant risks, regulatory requirements etc.

In developing these principles, the report noted:

“On the one hand, good governance should intrinsically include effective climate governance. To this point, climate change is simply another issue that drives financial risk and opportunity, which boards inherently have the duty to address with the same rigour as any other board topic. On the other hand, climate change is a new and complex issue for many boards that entails grappling with scientific macroeconomic and policy uncertainties across broad time scales and beyond board terms. In this regard, general governance guidance is not necessarily sufficiently detailed or nuanced for effective board governance of climate issues¹⁶.”

The World Economic Forum established [The Climate Governance Initiative](#)¹⁷ to promote the implementation of these principles by mobilising non-executive directors to drive action in this area. The initiative has operational Chapters (often called Chapter Zero) in Brazil, Brussels, Canada, Chile, France, Germany, Italy, Malaysia, Nordics, Poland, Russia, Switzerland, the United Kingdom and United States. A chapter was set up in Australia in August 2021¹⁸. Investors encourage company directors and senior management to support the initiative and implement the principles.

The links between the investor expectations laid out in this report and the World Economic Forum Climate Governance Principles are provided in the Appendix of this report.

Climate competent board

The objective of the board is to develop a coherent company strategy and appropriate risk oversight, and to select and appropriately reward the CEO to generate long-term value not only to shareholders, including institutional investors, but also to other stakeholders.

It is recognised that climate change is not the only issue or necessarily the dominant issue facing boards. Boards use committee structures and rely on the collective skills of individual directors in fulfilling their duties. They also rely on management systems, such as a company's risk management system, to identify, assess, manage and review issues that are critical for long-term value creation.

A climate competent board

A climate competent board is one that effectively integrates climate change into all the components of board governance. It can demonstrate, through its public disclosure, that it has the structures, systems and capability to ensure it integrates climate change into the short-, medium- and long-term company strategy and the oversight of company risk management.

A climate competent director

As noted above, it is recognised that boards need a variety of skills and backgrounds to successfully execute their remit. Individuals bring demonstrated expertise to the board over and above a mere familiarity with a particular area. For example, an ex-CFO bringing finance and accounting expertise. For many companies, it is necessary for a board to demonstrate that one or more of the directors can bring significant expertise on the multifaceted and complex issues of climate change.

While there are several ways the expertise of such a director could be described, for the purposes of this report a 'climate change competent director' can clearly demonstrate from their background that they have the expertise and experience of climate-related threats and opportunities including climate science, low carbon transition across the value chain and public policy. As with accounting and finance, a general understanding of climate change, while appropriate for directors to have, is not considered sufficient to make a director 'climate competent'.

A climate change competent director

A climate change competent director has expertise and experience of climate-related business threats and opportunities including climate science, low carbon transition across the value chain and public policy.

Not every board needs a climate competent director, as defined above, on the board. Indeed, there are few directors, or potential directors, who could currently claim the expertise across all the multi-faceted aspects of climate change that are relevant for many companies. However, it will be important that Australia develops a cohort of directors that can meet that definition. In the meantime, companies need to demonstrate that they have a good understanding of the climate change issues facing the company and, in many cases, rely on external expertise.

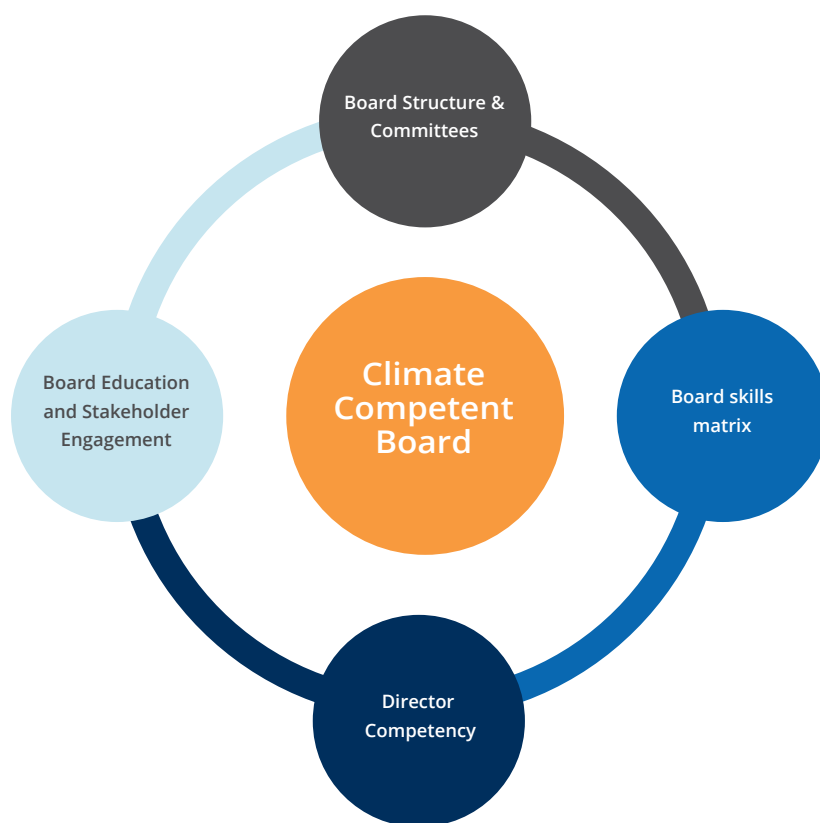
Components of a climate competent board

Overview

The components of a climate competent board are:

1. Board and committee charters clearly identifying responsibility for climate change or aspects of climate change issues relevant to the company.
2. Recognition of the director skill sets needed to address the issues related to climate change.
3. Directors clearly demonstrate the climate change-related skills identified in the skill matrix.
4. Demonstrated continual education and engagement with stakeholders by the board on relevant climate change issues.

It is recognised that many, if not most directors, have not had the business background or experience needed to effectively cover all aspects of climate change. In some cases, it may be appropriate that the board relies on external expertise on a particular climate change issue to enable them to make informed decisions.



These four areas are the demonstrable inputs to a board that investors can assess in determining a board's climate change competency.

Board structure and committees

Observations of current practice

CA100+ focus companies typically allocate responsibility for the management of climate risk as a responsibility to an existing board committee, typically the sustainability committee.

The remit of the sustainability committees of CA100+ focus companies, as reflected in the charter, typically has a focus on compliance or reputational issues of operated facilities. In many cases, the climate change remit refers only to greenhouse gas emissions and treats climate change as one of a number of environmental issues. The remit typically does not cover climate change issues associated with the value chain, for example scope 3 emissions, technology development, or non-operated facilities in which the company may have an equity interest.

In the last two years, with the greater focus by investors and companies on climate risk disclosure, some of the CA100+ focus companies have expressly acknowledged the financial risks of climate change by specifically referring to TCFD reporting within the responsibility of the risk, or audit and risk, committees.

Only one board of the fifteen companies analysed identified climate change strategy as a responsibility of the board.

In addition, only a small number of companies provided details of the specific activities of all board committees, including activities relevant to climate change governance. Several CA100+ companies referred to oversight of the company's Sustainability Report as being part of the responsibility of the sustainability committee.

Investor's expectations of board committee roles and disclosure of board committee's activities

It is not the investor's role to stipulate precisely how boards should structure responsibility for climate change. It is recognised that there are several credible approaches. However, investors do want to see how responsibility and accountability for climate change are addressed by the board and which board members are responsible.

While some committees appear to be given some responsibility for climate change, there is almost no disclosure around how committees are meeting this obligation.

The [UK Corporate Governance Code](#)¹⁹ provides a model. The Code requires companies, on a comply or explain basis, to explain the work of the nomination (Provision 23), audit (Provision 26) and remuneration (Provision 21) committees in the Annual Report. For example, Provision 26 requires reporting of:

"The significant issues that the audit committee considered relating to the financial statements, and how these issues were addressed".

Companies subject to the Code are required to provide additional disclosure on the current and future activities of their main board committees. Such disclosure provides investors insights into the focus of the board and, in particular, the amount of time and areas of focus the board is placing on material issues.

Summary of investor expectations on climate change governance and board committees

1. Board committee(s) have specific responsibility for the strategic, operational, technology, non-operational, value chain and financial aspects of climate change.
2. The risks from climate change are multi-faceted and boards need to demonstrate how climate change risks are captured through the Terms of Reference or Charters of specific committees. It is recognised that some aspects of risk are not climate change specific, e.g. reputational.
3. Specific oversight of TCFD reporting should be identified.
4. Board committees should disclose the significant climate change related issues that they have considered, and plan to consider in the coming year, and the outcome of these considerations.

Board skills matrix

Observations of current practice

Since 2015, the ASX Corporate Governance Council has recommended that listed entities 'should have and disclose a board skills matrix setting out the mix of skills that the board currently has or is looking to achieve in its membership'²⁰.

While a highly material issue for CA100+ focus companies, climate change has only recently been added to the board skills matrices of the companies reviewed and typically falls under environmental safety and social issues.

Several of the CA100+ focus companies have explicitly acknowledged the need for the board to understand and have "experience" in managing climate change as a stand-alone skill. While this acknowledgment is encouraging, it was unclear what "experience" is considered relevant by a board when assessing whether a director had the skill or experience. For example, one CA100+ focus company states that all its directors had "climate change" skills but provided no evidence for this. Another CA100+ focus company has never included environmental, safety and social skills in its skills matrix.

Most companies identify "experience in the industry" as a necessary skill for the board. While this experience is needed, few companies identify the need for directors with experience that will challenge the anchoring that appears to characterise the strategies of these companies. In addition, many did not identify the skills needed to deal with the disruption facing the company due to climate change and other disruptive forces.

The current level of disclosure leaves investors with more questions than answers about the composition of boards. While all companies assessed disclosed a board skills matrix, some of the companies provide only a list of skills, while others provide a brief description of what the skill encompasses. The brief description is more useful than a list of skills however, investors are still left uncertain about the criteria used for assessing the level of experience or knowledge of directors. It is unclear whether the benchmark for possessing a 'skill' is a basic understanding or general awareness of the issue or if a high-level of experience and expertise is required.

Investor's expectations of skills matrix make-up and disclosure

Not every board skills matrix can be expected to identify a climate competent director, as defined as:

A climate change competent director has expertise and experience of climate-related business threats and opportunities including climate science, low carbon transition across the value chain and public policy.

However, boards should be encouraged to consider the inclusion of climate competent directors where climate risks are very material for the firm. As well as identifying climate skills, the board skills matrix set should include the specific skills needed by the company to adequately respond to the market, technology and policy disruption that many companies face due to climate. Also included should be detail on what level of competency a director needs to meet the level of skill or experience indicated in the matrix, which should also include assessment criteria and independent verification or audit. It is recognised that some of these skills may be challenging to identify in board candidates and other measures (eg. board education and stakeholder management) may be required.

Summary of investor expectations for incorporating climate change into the board skills matrix

1. Report on how the skills matrix is developed and the process of assessing director skills.
2. Independent assessment, or audit, of company director skills.
3. A brief description of the criteria the board uses to assess each skill or background in the skills matrix.
4. Differentiation between directors with significant expertise or experience of a particular skill, versus knowledge or awareness in a particular area. This applies not only to climate change-related skills but all skills identified in the board skills matrix.
5. Disclosure of board succession plan outlining how necessary climate change-related skills will be brought onto the board.

Regarding specific skills required on the board, investors are looking for:

6. Technology and innovation: specifically recent experience and expertise with the development, selection and implementation of business transforming technology and innovation, and responding to climate-related and digital disruption.
7. Oil and gas company board skill sets should include “Company transformation”, i.e., a demonstrated ability to constructively challenge conventional business models that are facing significant disruption and redirect a company’s core competencies into a viable alternative strategy.
8. Utility company board skill set should include “Dealing with strategic disruption”, i.e. demonstrated experience in successfully guiding a company through a disruption that is fundamentally challenging the company’s business model.
9. “Climate competent” directors, i.e. has the expertise and experience of climate-related business threats and opportunities including climate science, low carbon transition across the value chain and public policy.

EXXONMOBIL 2021 BOARD CHANGES

In 2021 a minor shareholder of ExxonMobil undertook a campaign to unseat and replace several board members at the oil and gas supermajor.

In its campaign, ‘Re-energise Exxon’, the hedge fund Engine No. 1 argued that the company’s returns had been poor over the previous decade, that its current leadership did not have sufficient skills and expertise to manage the transition to a decarbonising world, and that new directors could address the ‘anchoring’ approach from the incumbent board.

Engine No. 1 put forward four candidates to the shareholders of Exxon for consideration. All had relevant industry experience (energy, oil and gas) but the candidates also had demonstrated experience in challenging the conventional wisdom of the industry business model and a deep understanding of the long-term dynamics which are shaping the industry.

Three of the four candidates proposed by Engine No. 1 were elected by shareholders to the ExxonMobil board in May 2021.

Director competency and backgrounds

Observations of current practice

Very few current board directors of the CA100+ focus companies reviewed can clearly demonstrate, through the description of their skills and experience presented in annual reports or in other online sources, that they would meet the requirements of a “climate competent” director. Those that do demonstrate the requirements have clear experience in emerging climate change relevant technologies or challenging conventional business models.

It was observed that the pool of directors on CA100+ focus company boards was relatively small. Some directors were on several CA100+ focus company boards, had recently retired from a board of a similar company, or had very similar career backgrounds often at the same companies. These trends suggest that current boards are not benefiting from fresh insights and new leadership, and that anchoring to existing business models may play a role.

The directors on the sustainability committee of many CA100+ focus companies typically did not have any demonstrable experience or background in dealing with environmental, safety and social issues. A director’s stated experience of working in a similar carbon or emission-intensive company, does not demonstrate that they bring the expected level of expertise.

A small number of current and past directors of CA100+ focus companies were found to have a history of stifling action on climate change, either directly or being in senior and responsible positions within companies that did. Several directors have made public statements against climate science or effective policy action. Some of the companies support industry associations that have stifled action on climate change. The outcomes of this negative lobbying have had a profound impact on Australian climate politics and have made climate and energy investment settings in Australia less stable and consistent than they may otherwise have been. This raises concerns that directors with this history are likely to be playing a similarly obstructive role in their current positions.

Investor expectations of director experience and background

Better disclosure is required of the individual expertise directors bring to the board regarding climate change and other relevant skills such as transformation, disruption and change management. Further, these companies need directors that recognise the need for change and proactive management of climate change risks and opportunities. Directors that anchor companies to existing business models or stifle policy or corporate action on climate change are unlikely to meet investors’ expectations.

Summary of investor expectations on director experience and background

1. Disclosure of relevant experience and expertise: Details of director backgrounds needs to demonstrate the expertise and experience they bring to the board, such that it is clear from director information the basis of the assessment of the board’s skill matrix. This should be clear in the director’s past experience as well as listed in the matrix.
2. Constructive contribution to climate change policy development: Directors are expected to provide a positive and consistent contribution to climate change policy discussion. Companies should consider whether directors with a history of arguing for policy delay or inaction on climate change are appropriate.
3. Accountability for climate change governance: Directors, especially those of board committees will need to take responsibility and accept that investors will see them as accountable for the climate change competency of the board.

Board education and stakeholder engagement

Observations of current practice

Only one of the fifteen CA100+ Australasian focus companies reviewed has an external advisory board that provides expert input on climate change. Very few CA100+ focus companies demonstrate how board directors are kept informed on the latest science, policy, technology, data and reporting requirements relevant to the company's response to climate change, so it is unclear how well informed these directors are despite climate change being a highly material issue for the companies.

Investor's expectations for board education and stakeholder engagement

As noted above, very few CA100+ focus company directors would individually be considered climate competent. However, it is important that directors are provided with an appropriate induction on the impact of climate change. Boards should also disclose how directors are increasing their understanding of relevant climate change-related issues through ongoing education, drawing on both internal and external expertise.

The TCFD guidelines have provided a framework for companies to better understand and have a more holistic approach to managing climate change. The framework has helped directors understand and assess climate change risk as more than another environmental risk. The TCFD reporting has also demonstrated some areas where there needs to be significant director upskilling, in particular, the use and assumptions behind the scenario analysis and the underlying assumptions used by the company in making investment decisions.

Summary of investor expectations for board education and stakeholder engagement

1. The board induction process includes relevant climate change issues facing the company, the company's climate change strategy and the board's climate change risk management oversight.
2. The board demonstrates that over the year it has continued to be educated about the relevant climate-related risks and opportunities for its business.
3. The board demonstrates that over the year it has engaged external expertise and stakeholders, including shareholders, on climate change issues.

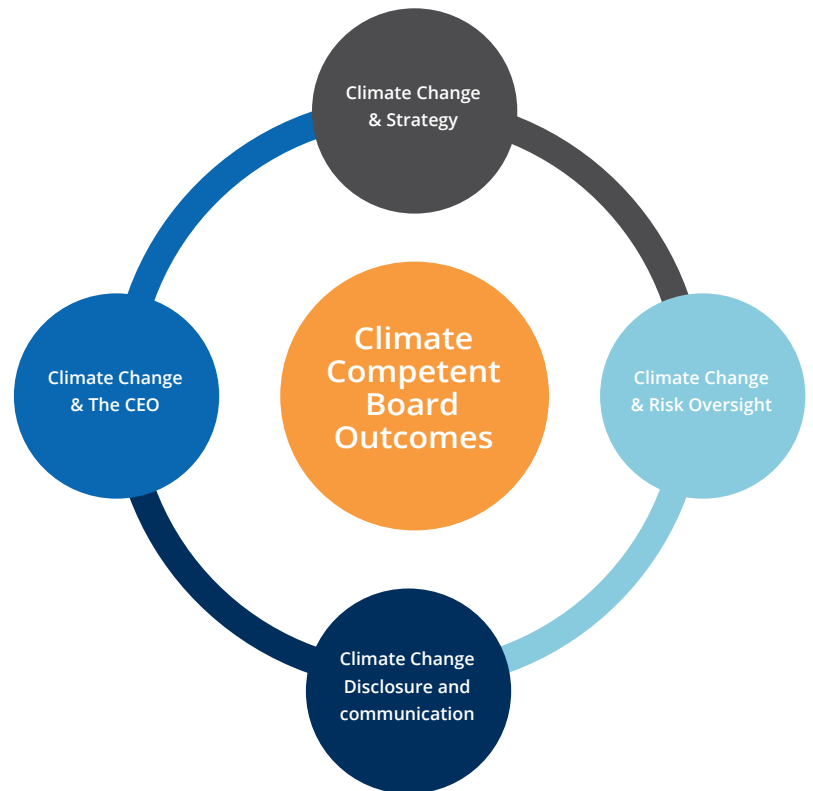
Outcomes from a climate competent board

Overview

This section focuses on the outcomes what should be expected from a climate competent board.

The components of a climate competent board cover the structure, skills needed and the informational inputs into board decision-making. Whether these combine with the board priorities and decision-making processes will be reflected in the outcomes of the board, namely:

1. Climate change integrated into company's strategy
2. Comprehensive climate change risk management oversight
3. Chair leadership and CEO and senior executives incentivised to address material climate change issues
4. Investor-aligned climate change disclosure



Climate change and strategy

Observations of current practice

Many companies fail to demonstrate a coherent climate change strategy that is fundamentally integrated into the overall company strategy. While many companies have improved disclosure of climate risks partly due to integration of the TCFD recommendations, the strategy and capital allocation decisions of most companies are misaligned with the Paris Agreement objective of limiting global warming to 1.5°C.

Companies continue to sanction new carbon intensive projects while also allocating capital to projects, research and development or partnerships to reduce emissions. Often the 'business as usual' investments are far larger in dollar terms. At best this is sending mixed messages to the market about how genuine companies are about reaching their targets. This inconsistency, or misalignment, raises questions in the minds of investors about how well climate change is being integrated into company strategy and how coherent the board's approach to climate change is.

Over the last ten years, several CA100+ focus company strategies appear to have either a short-term focus or have seriously misjudged the pace of change, especially global changes. As a result, investors are seeing widespread and abrupt corporate actions, asset write-downs and other costly strategy reversals, which suggests the board is not prepared for the transition to net zero and not appropriately using or understanding scenario analysis and other tools.

Investors have also seen companies avoid expenditure on simple and low-cost emission abatement opportunities as part of major capital investments, only to face significantly higher costs to retrofit later due to the need to reduce emissions.

Many companies' climate strategies rely heavily on the use of carbon offsets and technologies like carbon capture and storage. As more companies rely on these strategies, investors are increasingly concerned over issues like permanence, additionality, cost and future liability. There is also an emerging legal risk of overstating or misstating the emissions profile of products, which could implicate directors.

Investors internationally and in Australia have also expressed concerns that companies and their industry associations are lobbying for policies that are misaligned with achieving the goals of the Paris Agreement. In some cases, companies and their associations are lobbying against the very policy settings (for example, carbon pricing) that would be required to make their proposed climate solutions economical.

Investors have seen the divestment by companies of emission or carbon intensive parts of their businesses. While this may reduce the company specific climate change risk, it fundamentally does not reduce global emissions nor the overall systemic climate risk.

Investor expectations of climate change and company strategy

Companies should clearly articulate a coherent climate change strategy which is fully integrated into the company strategy including disclosure of underlying climate change-related assumptions. Climate disclosure should be conducted annually and the strategy refreshed accordingly, particularly in light of scenario analysis. The climate strategy should incorporate the opportunities for the firm arising from the transition and social aspects such as just transition and plans to responsibly wind down assets.

Summary of investor expectations of climate change and company strategy

1. Companies have a coherent climate change strategy which is integrated into the company's strategy.
2. Companies clearly articulate the underlying climate change related assumptions that lie behind the company strategy, particularly with respect to:
 - A. the rate of technology change assumptions
 - B. assumed policy settings
 - C. cost and other assumptions for negative emissions technologies and offsets
 - D. independently verified emission reduction targets for scope 1, 2 and 3 emissions
 - E. quantified abatement activities that will contribute to meeting the company's targets.
3. Companies undertake robust climate change scenario analysis and disclose capital investments or assumptions inconsistent with the Paris Agreement objective of aiming to limit global warming to 1.5°C.
4. Companies integrate the management of broader social impacts that may result from changes in company business models.
5. The strategy takes advantage of the opportunities that arise from action on climate change.
6. Carbon offsets are used as a last resort in the company's medium- to long-term strategy to manage climate change.
7. The climate change transition strategy for oil and gas companies is the company strategy.
8. Companies should avoid fossil fuel divestments in their strategy and instead focus on responsible wind downs of assets over a period in consultation with the community.

Climate change and risk oversight

Observations of current practice

Companies have increased their recognition of climate change risks and opportunities over the last couple of years, corresponding to the introduction of the TCFD guidelines.

Several CA100+ focus companies have only identified climate change as a strategic risk in the last three or four years. In many cases, the nature of the risk is only vaguely described or focuses on risks associated with changes to domestic policy and regulation. Technology risks (and opportunities), market risk, litigation and physical risks, including those in the company's value chain, were not identified. Oil and gas companies, in particular, appear to ignore or dismiss the risk to their future business of a substantial decrease in demand or price.

A board's sustainability committee is typically responsible for climate change as part of broader environmental and social issues. However, several CA100+ focus companies have recently moved climate change responsibility to the risk and audit committee. As described elsewhere in this report, a risk lens may help promote a longer-term focus on climate change, which may also support better outcomes.

Investor expectations for climate change and risk oversight

Boards should ensure that the risk management processes are adequate in identifying, assessing and managing climate change risks. If required, the board should ensure risk processes are adapted to address some of the challenging and unique aspects of climate change risk as described below.

Climate change should be considered as more than an environmental risk confined to compliance, regulation and reputation, given the much larger scope of risks that climate change presents to companies.

TCFD guidance on risk management and disclosure²¹

The TCFD guidance on risk management notes that climate change risks are more multifaceted and complex than many other risks faced by companies. Investors expect companies to address this via a comprehensive assessment of climate change risk and opportunities and full integration within existing risk management processes.

The guidance notes:

Given some of the unique characteristics of climate-related risks, companies may want to consider expanding their prioritisation criteria to include “vulnerability” and “speed of onset.” These prioritisation criteria are defined as follows:

“Vulnerability refers to the susceptibility of a company to a risk event in terms of the company’s preparedness, agility, and adaptability. Vulnerability is related to impact and likelihood — the more vulnerable the company is to the risk, the higher the impact is if the event occurs. If risk controls are not in place and operating as designed, then the likelihood of an event increases.”

Vulnerability and speed of onset are particularly useful for companies in the oil and gas sector. The certainty and the scale of the impact on an oil and gas company’s business model from climate change mean that it is a significant strategic risk. For these companies, climate change risk is not a question of ‘if but when?’²² and whether the company has or can transform its business model at rate faster than the onset in the decline of fossil fuel use.

Through better risk disclosure and appropriate risk management and governance, investors can have greater confidence of the board’s climate competence. The features of effective disclosure that investors are looking for are discussed more in the disclosure and communication section of this report.

Summary of investor expectations for board climate change risk oversight

Investors do not want a separate risk management process for managing climate change-related risks but do want disclosure by companies to make clear:

1. The process of identifying and considering all the financial, operational and strategic aspects of climate change risk and that these have been considered over the short-, medium- and long-term, recognising that some climate change risks may only manifest themselves in the medium- to long-term, e.g. physical risks.
2. The process of how climate change is integrated into the company's overall risk management process and how the existing process has been adapted to incorporate the specific characteristics of climate change risk which mean that existing risk management frameworks are not adequate.
3. The risk appetite for climate change risks and the processes to manage the climate change risks.

Climate change leadership and the CEO

Observations of current practice

Many CA100+ focus companies appeared to have inconsistencies in climate change leadership.

Changes in the Chair over the last six years of some of the CA100+ focus companies led to mixed results regarding how a company board appears to be addressing climate change. Some have brought a more engaged and proactive approach to climate change within the company, while others appear to reinforce the existing business model. Where the CEO is leading the climate strategy, CEO departures have often halted progress, suggesting weaknesses in buy-in at board level.

It was observed that very few of the CA100+ focus companies have linked CEO and executive remuneration to climate action and those that have, have only done so in the last two years. Of the fifteen CA100+ focus companies reviewed, only one linked the company's decarbonisation plan to the CEO's long-term incentive scheme.

In several cases the incentives to address climate change conflict with other incentives, such as incentivising fossil fuel production growth.

Investor expectations for climate change leadership and the CEO

The Chair and CEO should show external and internal leadership on a company's climate change strategy. A key aspect of this is to remove inconsistencies in what the company says, does and rewards regarding action on climate change.

Climate change should also be integrated into the remuneration strategy of companies including short- and long-term incentives²³ recognising there is not a one-size-fits-all approach for all companies.

Summary of investor expectations for climate change board leadership and the CEO

1. CEO and Chair to show leadership on company action on climate change by ensuring action on climate change and minimise misalignment or inconsistencies in the approach to climate change across the company.
2. Remuneration structures of the CEO and key performance indicators (KPIs) should incentivise achievement of the climate strategy and emissions reduction targets.
3. Remuneration structures should not include incentives which are inconsistent or conflict with improving a company's climate change resilience and reducing emissions.

Climate change disclosure and communication

Observations of current practice

Reports and presentations are essential mechanisms to report to institutional investors the company's strategy, risk management and action on climate change. Annual reports, CEO and Chair speeches at AGMs, presentations at strategy days and annual results are used to assess the focus, consistency and approach to climate change the company communicates to investors on climate change.

Since 2018, investor-relevant climate change disclosure has improved with an uptake of TCFD-aligned reporting by companies including all the CA100+ focus companies assessed. Most CA100+ focus companies currently include climate change in the sustainability report, some in the annual report and a smaller group produce dedicated climate reports.

The reliance on the sustainability report to disclose climate change-related information commonly means that:

- Key climate change risks are not adequately addressed, if at all. For example, technology, market or value chain (scope 3 emission) risks.
- Some of the unverified claims made in reporting may be considered greenwashing or materially misleading.
- Data or targets are not aligned with the investor or company exposure. For example, emissions reported or reduction targets are for operated facilities when the majority of emissions exposure is through non-operated facilities or the value chain.
- Discussion about physical climate change impacts is typically very limited even though physical climate change risks are identified as being one of the main strategic risks.

Very few CA100+ focus companies discuss their action on climate change in other parts of the annual report, such as the CEO or Chair comments or investor reporting. In some cases, company disclosure through these other channels appears to conflict with the climate change disclosures, as companies focus on carbon intensive growth projects or markets. While there has been improvement in recent years, investors will be concerned over the demonstrated lack of focus on climate risk by the board.

Investor expectations for climate change disclosure and communication

Consistency, comprehensiveness and transparency are key characteristics of climate change disclosure that investors use to assess the climate competency of a company board. Consistent disclosure and communication on how a company is managing climate change across all channels used to communicate to investors is required.

The TCFD guidelines²⁴ provide a well-regarded framework for reporting to investors and should be part of mainstream financial filings. Investors have been calling for TCFD-aligned disclosure to be mandatory in Australia²⁵. Companies should refer to the TCFD guidance and present disclosures with sufficient detail and completeness to enable investors to assess the company's exposure and approach to addressing climate-related issues. If this information is not presented to investors, it raises questions over whether the board is adequately informed of the impact of climate change on the company.

Increasingly, companies are providing investors with a 'say' on the company climate transition plan and disclosures. Several Australian and global firms have committed to provide a shareholder vote known as a "Say on Climate"²⁶ on the company climate disclosures at their 2021 and 2022 AGMs. This is a useful mechanism to ensure investors can provide feedback on companies plans on an annual basis.

Summary of investor expectations on climate change disclosure and communication

1. Consistent, comprehensive and complete climate change disclosure and communication across all channels used to communicate to investors.
2. Prepare a TCFD reporting that:
 - A. Provides a thorough overview of the company's governance, strategy, processes for managing climate-related risks and performance with respect to managing climate-related risks
 - B. Considers all climate change risks and opportunities
 - C. Presents information in sufficient detail and sets targets, including emission reduction targets that can be used to assess performance of the company
 - D. Considers and addresses the different timeframes and types of impacts
 - E. Has as an objective to communicate financial information which is sufficiently granular, that serves the needs of a range of financial sector users
 - F. Explains any changes in approach
 - G. Includes robust scenario analysis as noted below
 - H. Identifies the current and future capital expenditure of investments that are inconsistent with achieving a 1.5°C scenario
 - I. Is presented to investors through the mainstream channels used to communicate to investors.
3. Includes scenario analysis in its reporting which discloses:
 - A. A 1.5°C scenario such as the IEA's Net Zero 2050 scenario
 - B. Critical input parameters, assumptions, and analytical choices for the scenarios used should be clearly articulated, including factors such as:
 - i. Assumptions about possible technology responses and timing (e.g. evolution of products and services, the technology used to produce them, and costs of implementation)
 - ii. Assumptions made around potential differences in input parameters across regions, countries, asset locations, and/or markets
 - iii. Approximate sensitivities to key assumptions.
4. Prepare an annual "Say on Climate" vote for the company's AGM.
5. Climate reporting should be incorporated into the company's financial statements using the financial metrics typically used by the company, e.g., Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA).

CONCLUSION

Companies play a key role in delivering emission reductions and managing climate change impacts. Managing climate change is inextricably linked with company strategy, risk management and capital allocation. These areas are core to the role of boards.

Over the last few years, with the implementation of TCFD reporting, there has been some improvement, evidenced by the way Australian company boards have been considering climate change. A growing group of companies including nearly all the companies assessed for this report have also committed to net zero emissions by 2050, which is an important market signal. Despite this good progress, many companies and their boards are not taking an integrated approach to climate change with inconsistencies and sometimes conflicting agendas presented to investors. Current board structures, skills and directors do not reflect what is required of a climate competent board.

Investors want to see the companies they are invested in continue to create value for shareholders and the broader community. However current company strategy, risk oversight, CEO and Chair leadership and investor disclosure and communication does not indicate that some boards are up to the task of addressing climate change. If this trend continues it is possible that shareholder frustration with companies will play out in ways that affect company directors. In 2021 there have already been several significant votes for climate-related shareholder resolutions at company AGMs including AGL Energy Ltd, Bunge, Chevron, ConocoPhillips, DuPont de Nemours, ExxonMobil, and Rio Tinto. Similarly, the world's largest asset manager, Blackrock, disclosed that it voted against the re-election of 255 directors during the 2020-2021 financial year for "climate-related concerns that could negatively affect long-term shareholder value²⁷." Directors that are responsible for remuneration and the appropriate incentivisation of climate strategy, risk and audit, and the sustainability committee, as well as the overall leadership of the Chair are likely to see their performance closely examined by investors.

The expectations in this report outline some useful engagement topics investors can pursue with company boards to lift the standard of climate change governance in Australia. Fortunately, in Australia, there is a preference for constructive engagement between investors and company directors. This is the approach many investors want to continue to have with companies because they believe it will deliver the best outcomes.

The time for action on climate change is running out but company boards, with support from investors, can, and must, position companies to manage the multifaceted aspects of climate change risk but also to benefit from the opportunities presented by the transition to net zero and to create long-term value for shareholders and society.

Appendix – Link between Investor Expectations and World Economic Forum Climate Change Governance Principles

Board structure and committees	<ol style="list-style-type: none"> 1. Board committee(s) have specific responsibility for the strategic, operational, technology, non-operational, value chain and financial aspects of climate change. 2. The risks from climate change are multi-faceted and boards need to demonstrate how climate change risks are captured through the Terms of Reference or Charters of specific committees. It is recognised that some aspects are risk are not climate change specific, e.g., reputational. 3. Specific oversight of TCFD reporting should be identified. 4. Board committees should disclose the significant climate change-related issues that they have considered and the outcome of these considerations. 	<p>Principle 1 – Climate accountability on boards</p> <ul style="list-style-type: none"> ➤ Do your board directors undertake decisions that are informed by the best available information on climate risks and opportunities (see Principle 4)? ➤ Do your directors feel confident in their abilities to explain their decisions as informed by the best available information on climate risks and opportunities? ➤ Does the board conduct internal performance reviews? Is accountability for climate risks and opportunities considered during internal evaluations of the board? <p>Principle 2 – Command of the (climate) subject</p> <ul style="list-style-type: none"> ➤ To what extent does your board have a robust awareness and understanding of how climate change may affect the company? ➤ Who is responsible for climate change at the board level and are these individuals in positions that will allow them to influence board decisions (e.g., committee chairs)? ➤ What steps is your board taking to ensure it remains sufficiently educated about the relevant climate-related risks and opportunities for its business? <p>Principle 3 – Board structure</p> <ul style="list-style-type: none"> ➤ Has your board determined how to effectively integrate climate considerations into the board committee structures? Are they integrated into (an) existing committee(s)? Or are they addressed by a dedicated specific climate/sustainability committee? ➤ How does your board ensure that climate considerations are given sufficient attention across the board (e.g., being discussed in the audit, risk, nomination or remuneration committees)?
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Board skills matrix	<ol style="list-style-type: none"> 1. Report on how the skills matrix is developed and the process of assessing director skills. 2. Independent assessment, or audit, of company director skills. 3. A brief description of what the board envisages is encompassed by each skill or background in the skills matrix. 4. Differentiation between directors with significant expertise or experience of a particular skill, versus knowledge or awareness in a particular skill. This applies not only to climate change related skills but all skills identified in the board skills matrix. 5. Disclosure of board succession plan outlining how necessary climate change-related skills will be brought onto the board. <p>Regarding specific skills required on the board, investors are looking for:</p> <ol style="list-style-type: none"> 6. Technology and innovation: specifically recent experience and expertise with the development, selection and implementation of business transforming technology and innovation, and responding to climate-related and digital disruption. 7. Oil and gas company board skill sets should include: "Company Transformation", i.e., a demonstrated ability to constructively challenge conventional business models that are facing significant disruption and redirect a company's core competencies into a viable alternative strategy. 8. Utility company board skill set should include: "Dealing with strategic disruption", i.e., demonstrated experience in successfully guiding a company through a disruption that is fundamentally challenging the company's business model. 9. "Climate competent" directors, i.e., has the expertise and experience of climate-related business threats and opportunities including climate science, low carbon transition across the value chain and public policy. 	<p>Principle 2 – Command of the (climate) subject</p> <ul style="list-style-type: none"> ➤ To what extent does your board have a robust awareness and understanding of how climate change may affect the company? ➤ What steps has your board taken to test that its composition allows for informed and differentiated debate as well as objective decision-making on climate issues? ➤ Has an assessment of climate-competence gaps taken place? If so, who is conducting such gap analysis and what recommendations does it contain? ➤ Who is responsible for climate change at board level and are these individuals in positions that will allow them to influence board decisions (e.g., committee chairs)? ➤ What steps is your board taking to ensure it remains sufficiently educated about the relevant climate-related risks and opportunities for its business? ➤ How can your board plan for succession to ensure that climate awareness does not stop if an important individual or a vocal climate champion leaves the organization or the board? What kind of skills do you incorporate into the desired profile for a new board director? <p>Principle 3 – Board structure</p> <ul style="list-style-type: none"> ➤ Has the board considered appointing a climate expert, or creating an informal or ad-hoc climate advisory committee of internal and external experts?
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<p>Director competency and backgrounds</p>	<ol style="list-style-type: none"> 1. Disclosure of relevant experience and expertise: Details of director backgrounds needs to demonstrate the expertise and experience they bring to the board, such that it is clear from director information the basis of the assessment of the board's skill matrix. 2. Constructive contribution to climate change policy development: Directors are expected to provide a positive and consistent contribution to climate change policy discussion. Companies should consider whether directors with a history of arguing for policy delay or inaction on climate change are appropriate. 3. Accountability for climate change governance: Directors, especially those of board committees will need to take responsibility and accept that investors will make them accountable for the climate change competency of the board. 	<p>Principle 2 – Command of the (climate) subject</p> <ul style="list-style-type: none"> ➤ What steps has your board taken to test that its composition allows for informed and differentiated debate as well as objective decision-making on climate issues? ➤ Has an assessment of climate-competence gaps taken place? If so, who is conducting such gap analysis and what recommendations does it contain? ➤ Who is responsible for climate change at board level and are these individuals in positions that will allow them to influence board decisions (e.g., committee chairs)? ➤ To what extent does your board have a robust awareness and understanding of how climate change may affect the company? ➤ Who is responsible for climate change at board level and are these individuals in positions that will allow them to influence board decisions (e.g., committee chairs)? ➤ How can your board plan for succession to ensure that climate awareness does not stop if an important individual or a vocal climate champion leaves the organization or the board? What kind of skills do you incorporate into the desired profile for a new board director?
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Board education and stakeholder engagement	<ol style="list-style-type: none"> 1. The board induction process includes relevant climate change issues facing the company, the company's climate change strategy and the board's climate change risk management oversight. 2. The board demonstrates that over the year it has continued to be educated about the relevant climate-related risks and opportunities for its business. 3. The board demonstrates that over the year it has engaged external expertise and stakeholders, including shareholders, on climate change issues. 	<p>Principle 1 – Climate accountability on boards</p> <ul style="list-style-type: none"> ➤ Do your directors feel confident in their abilities to explain their decisions as informed by the best available information on climate risks and opportunities? <p>Principle 2 – Command of the (climate) subject</p> <ul style="list-style-type: none"> ➤ What steps is your board taking to ensure it remains sufficiently educated about the relevant climate-related risks and opportunities for its business? ➤ Has your board considered whether it would benefit from the advice of external experts? If so, has the board considered which experts would be most well suited? <p>Principle 8 – Exchange</p> <ul style="list-style-type: none"> ➤ How does the board ensure that the company develops and encourages climate dialogue and methodology sharing among industry peers, investors, regulators and other stakeholders? ➤ How does your board maintain its awareness about good climate governance practices? ➤ Does your company organise stakeholder dialogues on this matter and encourage the participation and inclusion of all relevant stakeholders (customers, regulators, NGOs, academia etc.)? ➤ Is the board kept regularly informed of, does it approve, and does it supervise consistent conduct of the company's industry and public policy engagement?
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Climate change and strategy

1. Companies have a coherent climate change strategy which is integrated into the companies' strategy including capital expenditure.
2. Companies clearly articulate the underlying climate change-related assumptions that lie behind the company strategy and capital expenditure decisions, particularly with respect to:
 - A. rate of technology change assumptions
 - B. assumed policy settings
 - C. emission reduction targets for scope 1, 2 and 3 emissions.
4. Companies undertake robust climate change scenario analysis and disclose capital investments, or assumptions, inconsistent with the Paris Agreement objective of aiming to limit global warming to 1.5°C.
5. Companies integrate the management of the social impact that may result from changes in company business models.
6. The strategy takes advantage of the opportunities that arise from action on climate change.
7. Carbon offsets are used as a last resort in the company's medium- to long-term strategy to manage climate change.
8. The climate change transition strategy for oil and gas companies is the company strategy.

Principle 5 – Strategic and organisational integration

- Does your corporate strategy include a holistic climate strategy informed by scenario analysis, i.e., climate risk mitigation and adaptation as well as business continuity mitigation and adaptation as well as business continuity and opportunities?
- Are climate considerations incorporated into the strategic planning, business models, financial planning and other decision-making processes?

Climate change and risk oversight

Investors do not want a separate risk management process for managing climate change-related risks but do want disclosure by companies to make clear:

1. The process of identifying and considering all the financial, operational and strategic aspects of climate change risk and that these have been considered over the short-, medium- and long-term, recognising that some climate change risks may only manifest themselves in the medium- to long-term, e.g., physical risks.
2. The process of how climate change is integrated into the company's overall risk management process and how the existing process has been adapted to incorporate the specific characteristics of climate change risk which mean that existing risk management frameworks are not adequate.
3. The risk appetite for, and process to manage the climate change risks.

Principle 4 – Material risk and opportunity assessment

- Is climate considered in company-wide assessments of material risks and opportunities in the short-, medium- and long-term?
- How does your board verify that the company has embedded effective materiality assessment processes in relation to climate risks and opportunities?
- How does your board ensure that the company's response to climate change is aligned to the materiality and proportionality of the issue to the business?
- Are short-, medium- and long-term time frames considered in materiality assessments at your organisation? Are the definitions of these timeframes appropriate for your organization specifically (depending on the sector, size, investment timeframes etc. of your organisation)?
- How are climate-related materiality assessments conducted? Are they integrated into budget or operating cycle planning?
- Are different climate scenarios being included to inform the assessment of climate change materiality at your organisation?
- How often are climate-related scenario analyses repeated? Does your board feel this frequency is proportionate to the climate risk exposure of the company (i.e., do they take place sufficiently frequently)? Do your investors share the board view?
- Are climate scenarios conducted in such a way that the results can be used to inform the company's or board's action or response to climate issues?

Principle 5 – Strategic and organisational integration

- How does the board ensure that climate risks and opportunities are identified, mitigated, managed and monitored across the company?
- Does the board feel confident that sufficient resources (e.g., staff, technology) have been dedicated to the identification, mitigation, management and monitoring of material climate-related risks?

Climate change leadership and the CEO

1. CEO and Chair to show leadership on company action on climate change by ensuring action on climate change and minimise misalignment or inconsistencies in the approach to climate change across the company.
2. Remuneration structures of the CEO and key performance indicators (KPIs) should incentivise achievement of the climate strategy and emissions reduction targets.
3. Remuneration structures should not include incentives inconsistent or conflicting with improving a company's climate change resilience and reducing emissions.

Principle 6 – Incentivisation

- Is the company's management incentivisation scheme designed to promote and reward sustainable value creation over time?
- Are any climate targets and/or goals integrated into management's incentivisation model?
- If so, how do these targets and/or goals relate to other management incentives? Are there any inconsistencies or contradictions in relation to the other incentives?
- If variable incentives are extended to non-executive directors, do these include incentives related to climate and avoid potential conflicts of interest?
- Which climate KPIs, targets, goals and/or achievements does the board incorporate into the management incentivisation models (e.g., related into the management incentivisation models such as carbon emissions, science-based targets or inclusion in climate indices)?
- What are the benefits and limitations of using these KPIs, targets, goals and achievements?
- How does the board assess the suitability (ex-ante) and measure the effectiveness (ex-post) of climate-based performance incentives?

Climate change disclosure and communication	<ol style="list-style-type: none"> 1. Consistent, comprehensive and complete climate change disclosure and communication across all channels used to communicate to investors. 2. Prepare a TCFD report that: <ol style="list-style-type: none"> A. Provides a thorough overview of the company's governance, strategy and processes for managing climate-related risks, and performance with respect to managing climate-related risks. B. Considers all climate change risks and opportunities. C. Presents information in sufficient detail and sets targets, including emission reduction targets that can be used to assess performance of the company. D. Considers and addresses the different timeframes and types of impacts. E. Has as an objective that the communication of financial information, which is sufficiently granular, serves the needs of a range of financial sector users. F. Explains any changes in approach. G. Includes robust scenario analysis, including a 1.5°C scenario and clearly articulates assumptions made about technology, policy and market conditions. H. Identifies the current and future capital expenditure or investments that are inconsistent with achieving a 1.5°C scenario. I. Is presented to investors through the mainstream channels used to communicate to investors. 3. Prepare a "Say on Climate" vote for the company's AGM 	Principle 7 – Reporting and disclosure <ul style="list-style-type: none"> ➤ Does your organisation report on the material financial risks and opportunities associated with climate change? ➤ Does your organisation operate in jurisdictions with mandatory climate-related reporting? Is the board aware and informed about potential mandatory climate-related reporting requirements? ➤ Does the organisation report against relevant voluntary climate-related reporting frameworks in your jurisdiction (e.g., CDP, TCFD)? If not, has the board considered the potential risks associated with failing to do so? ➤ How does your board hold management accountable for implementing the regulatory requirements for climate-relevant disclosure and for maintaining oversight of emerging regulation? ➤ How does your board fulfil its duty in relation to the signing or attestation of its climate disclosures in annual reports or financial filings? ➤ Does the board feel confident that the level of climate-related disclosure is proportionate to the materiality of climate-related risks and opportunities at the company and complies with any mandatory reporting requirements? ➤ Does the board feel prepared to explain its disclosures on climate in response to investor-led challenges? ➤ Is the company reporting on areas where progress has been insufficient and/or where things have not gone to plan (consistent with national corporate governance codes)? ➤ Do disclosures include information about the company's industry and policy engagement on climate change?
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ENDNOTES

1. Adbri, AGL Energy Ltd, BHP, Bluescope Steel Ltd, Boral Ltd, Incitec Pivot, Oil Search, Orica, Origin Energy, Qantas Airways Limited, Rio Tinto, Santos Limited, South32, Woodside Energy, and Woolworths Group Ltd.
2. It may be appropriate that this remains the remit of the board rather than a specific board committee.
3. United Nations Framework Convention on Climate Change, 1992
4. <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>
5. <https://carbontracker.org/reports/unburnable-carbon-wasted-capital-and-stranded-assets/>
6. http://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2021.pdf
7. <https://www.unpri.org/sustainable-development-goals/the-sdgs-are-an-unavoidable-consideration-for-universal-owners/306.article>
8. Recognising the financial and economic significance of climate change, APRA, ASIC, RBA and the ASX have all published statements and/or specific regulatory guidelines and recommendations in relation to managing and reporting on climate-related financial risk
9. <https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf>
10. <https://cpd.org.au/wp-content/uploads/2021/04/Further-Supplementary-Opinion-2021-3.pdf>
11. "The Top 25 U.S. Electric Utilities: Climate Change, Corporate Governance and Politics" https://siinstitute.org/special_report.cgi?id=42
12. <https://engine1.com/campaign/its-time-to-reenergize-xom/>
13. <https://www.fsb.org/wp-content/uploads/P291020-2.pdf>
14. <https://australia.influencemap.org/policy>
15. <https://reneweconomy.com.au/inflection-point-is-agl-demerger-too-late-to-save-the-fossil-fuel-behemoth/>
16. <https://www.weforum.org/whitepapers/how-to-set-up-effective-climate-governance-on-corporate-boards-guiding-principles-and-questions>
17. <https://www.weforum.org/projects/climate-governance-initiative>
18. <https://aicd.companydirectors.com.au/resources/climate-change>
19. <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf>
20. <https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf>
21. https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Risk-Management-Integration-and-Disclosure.pdf
22. The IEA's Net Zero by 2050 scenario (<https://www.iea.org/reports/net-zero-by-2050>) highlights that the answer to the question of when (?) is now.
23. Short-term incentives: drive performance to near term strategy and underpinning value creation. Long-term incentives: drive long-term value creation for shareholders and encourage an owner's mindset and long-term decision making.
24. <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>
25. https://igcc.org.au/wp-content/uploads/2021/06/ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf
26. <https://www.sayonclimate.org/>
27. <https://www.bloomberg.com/news/articles/2021-07-20/blackrock-voted-against-255-directors-for-climate-related-issues>



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